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Annual Financial Review

FOOD MARKETING INSTITUTE

Conducted by:

Arthur Andersen & Co.
for the Research Division
FOOD MARKETING INSTITUTE
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EXECUTIVE SUMMARY

The Food Marketing Institute ("FMI") has been tracking the performance of the supermarket industry for the past eleven years. The 1982 Annual Financial Review (the "Review") was designed to promote a better understanding of the economics of the supermarket industry. This report provides the broadest and most representative sample of industry data available.

The Review was conducted for FMI by Arthur Andersen & Co. Information was derived from an extensive mail survey and from public financial reports.

The results of the Review indicate that while the supermarket industry is still feeling an adverse impact from a difficult operating environment, changes in shopping patterns and changes in consumer taste, profits rebounded from the all-time low experienced in 1981. Net income as a percentage of sales increased from .89 percent in 1981 to 1.06 percent in 1982.

In order to gain a better insight into store performance the Review has been stratified into three rather than two size groups. As in the past, the smaller companies emerged as the performance leaders. However, the disparity between mid-size companies and their smaller and larger competitors widened in 1982.

Net Income as a Percent of Sales

	Companies with sales under $10 million	Companies with sales between $10 and $50 million	Companies with sales over $50 million	Weighted Total
1981	1.04%	.47%	.90%	.89%
1982	1.34%	.51%	1.05%	1.06%

CONTENTS

Executive Summary 1

Financial Data and Ratios

Selected Economic Data 4
- Consumer Price Index—all urban consumers
- Consumer Price Index—food at home
- Average Prime Rates Charged by Banks

Industry Data 5
- Total Supermarket Sales
- Total Supermarket Net Income

Key Financial Ratios 6
- Profit Margin
- Return on Total Assets
- Return on Net Worth

Key Financial Ratios Adjusted for Inflation 8
- Profit Margin
- Return on Total Assets
- Return on Net Worth
- Effective Tax Rate

Financial Statements

Historical Cost Basis 11
- Income Statement
- Balance Sheet

Comparison: Historical vs. Inflation-Adjusted Balance Sheet Categories 14

Methodology 17

- Approach
- Inflation Adjustments
- Definitions

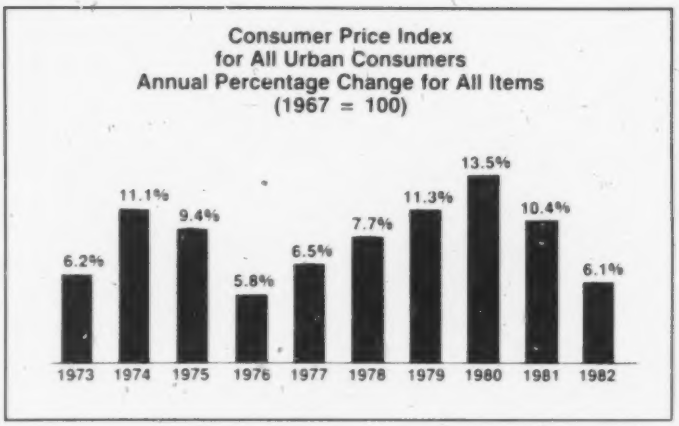
FINANCIAL DATA AND RATIOS

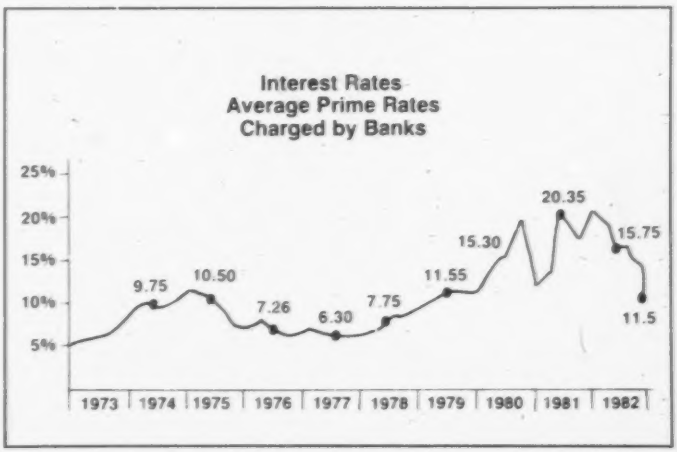
Selected Economic Data

In 1982, economic pressures began to decrease as the economy began to recover from the most severe recession in the last decade.

Inflation, as measured by the consumer price index for all urban consumers was 6.1 percent, the second lowest rate in the last ten years. The consumer price index for food consumed at home rose 3.7 percent. The impact on the drop in the rate of inflation on family budget can be seen in the continuing decline in the proportion of shoppers who say they find it harder to make ends meet.

Interest rates continued to drop from the record levels achieved in 1980. Nevertheless, the uncertainty over long term costs of financing and the lingering effects of the recession discouraged many companies from investing in significant capital improvements.





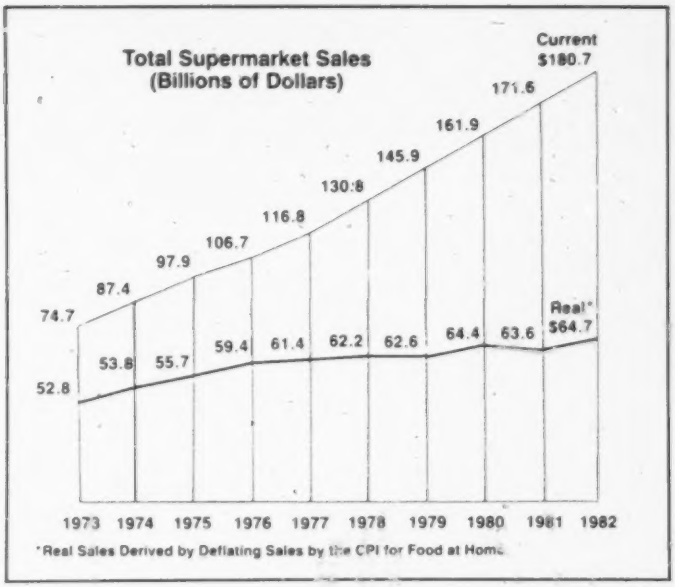
Industry Data*

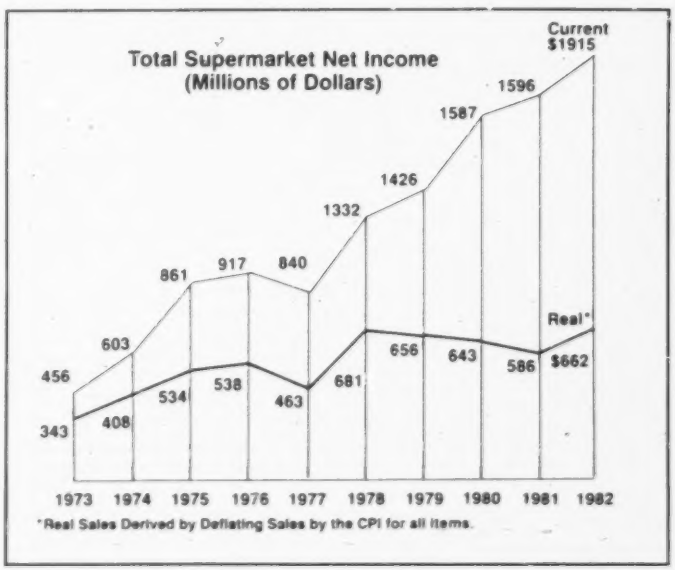
As measured in current dollars, total supermarket sales continued their long-term growth and reached a record $180.7 billion[1] in 1982.

Total supermarket net income was just over $1.9 billion. Adjusted for inflation, total supermarket net income in real dollars is $662 million. This was the first increase in the last four years and a 13 percent increase over 1981. However, it fell far short of the record total of $681 million in 1978 when total supermarket net income exceeded the previous year by almost 50 percent. The increase was also significantly less than the regular annual increases of 20 - 30 percent experienced in the early 1970's.

[1] Progressive Grocer

** Total supermarket sales and net income were deflated by the Consumer Price Indices that best reflect the underlying nature of the data. Since supermarket sales are comprised primarily of food, the sales data were deflated by the CPI for "food-at-home". Since supermarket net income is comprised of all revenue and expense accounts (many of which are not related to food), the net income data were deflated by the CPI for all items.*





Key Financial Ratios

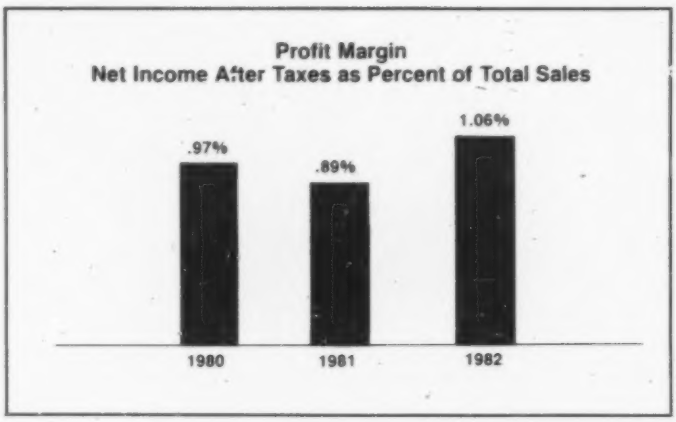
In measuring profitability, three financial ratios provide a good barometer:

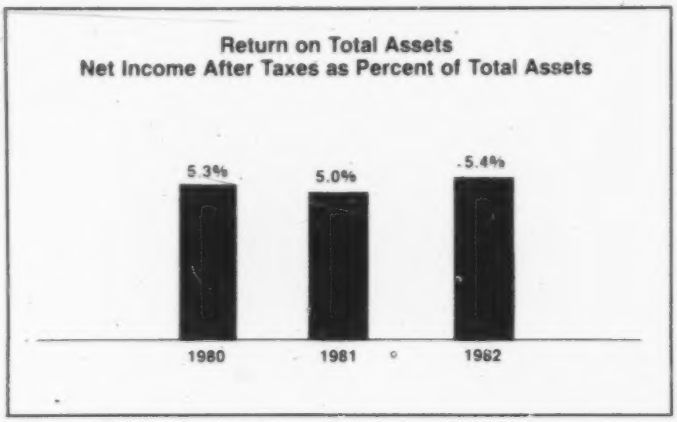
- profit margin
- return on total assets
- return on net worth.

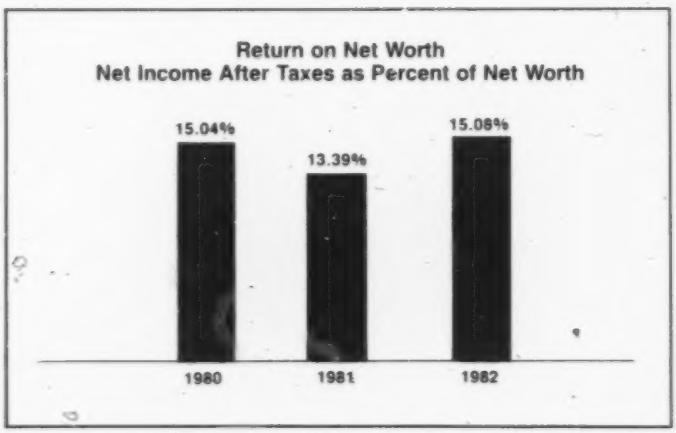
The profit margin is simply net income as a percentage of sales. It measures the portion of the industry's sales dollar that is left after paying all expenses. For the supermarket industry in 1982 the profit margin increased to 1.06 percent, the best performance in the last ten years.

Return on total assets is calculated by expressing net income as a percentage of total assets. It measures the ability of the industry's assets to generate profits. In 1982, the supermarket industry's return on total assets increased to 5.4 percent, exceeding the return experienced each of the previous three years.

Return on net worth is calculated by expressing net income as a percentage of net worth. It reflects the earning power of the stockholders' equity in the supermarket industry. Return on net worth in the supermarket industry increased to 15.1 percent in 1982, here again the best performances in the last ten years.







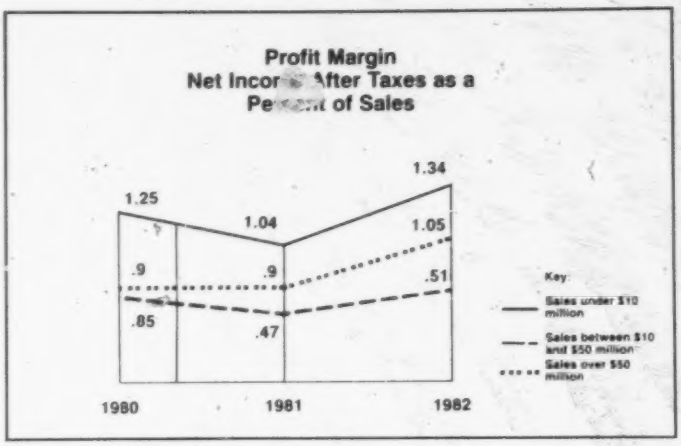
Over the last two years, three significant modifications have been made to our data series. First, the rapid inflation of the preceeding decade made obsolete the definition of a supermarket as "any retail food store carrying groceries, meat, and produce with annual sales of at least $1 million". The standard definition of a supermarket now requires a sales volume of $2 million.

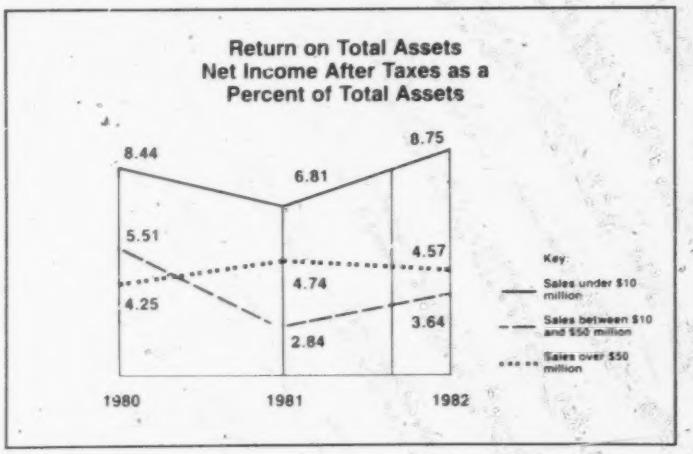
Second, the U.S. Census Bureau released their 1977 Census of Retail Trade. As a result, the sales volume weights used for each size category of firms changed.

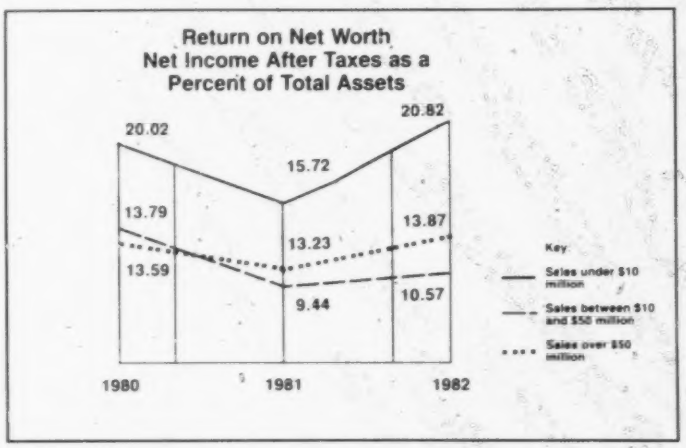
Third, to provide a more complete understanding of the industry, three size categories instead of two are now reported. A medium size category with sales between $10 million and $50 million has been added to the previous break of those under $10 million and those over $10 million.

In order to provide continuity for these changes, the 1980 and 1981 data have been recalculated from previous reports to be compatible with these changes. The three years shown in the 1982 Review are therefore, comparable data.

During the past three years the smaller companies (i.e. those with sales of less than $10 million) have outperformed the larger companies. As in 1981, mid-size companies (i.e. those with sales of more than $10 million, but less than $50 million) were the least profitable group.





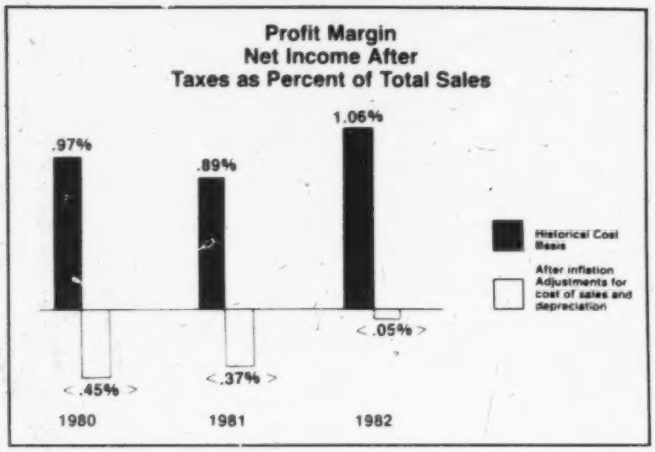


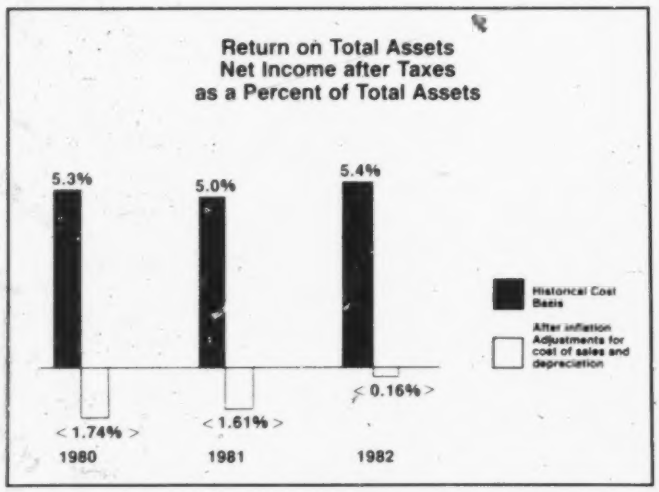
Key Financial Ratios Adjusted for Inflation

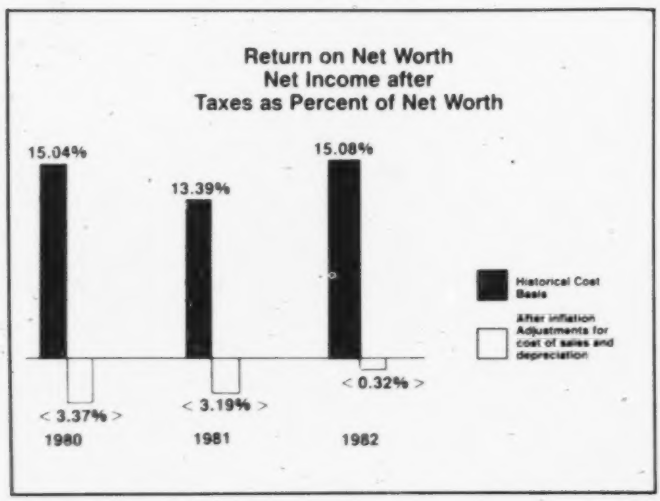
The performance measures discussed in the previous section are subject to distortion caused by inflation. For comparison, ratios are herein presented on an inflation-adjusted basis in order to more accurately reflect the economic well-being of the supermarket industry.

The inflation adjustments used in the Review are those prescribed by Statement of Financial Accounting Standards No. 33. Such adjustments restate "cost of sales" and "depreciation" from the amounts recorded in historical dollars to current dollars. In so doing, (1) the impact of profits realized on inventory are removed from the income statement, and (2) the depreciation charge is increased to reflect the current costs of replacing assets.

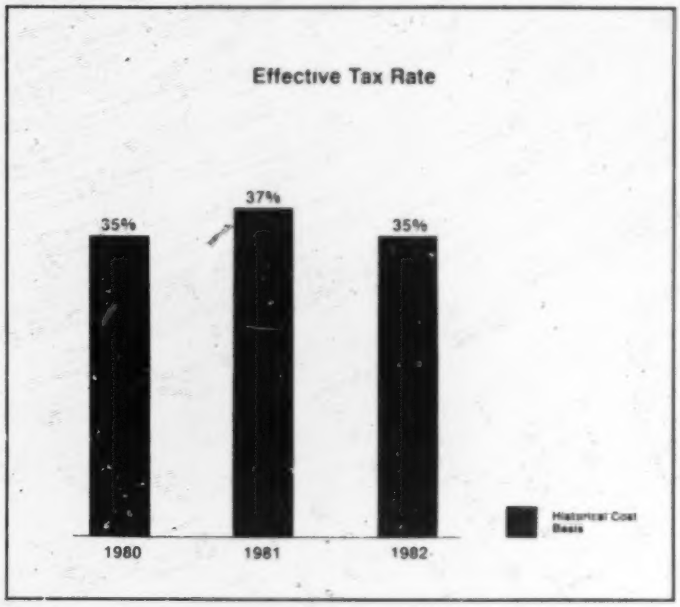
The inflation-adjusted ratios, while still negative, reflect improved operating results from prior years. In 1982, the profit margin, return on total assets and return on net worth were -.05 percent, -.16 percent and -.32 percent, respectively.







The impact of income taxes is that income taxes consume more, if not all (which is the case over the last several years), of pre-tax profits. Tax calculations for an individual company are based upon net income calculated on an historic cost basis, and no adjustments are made to reflect the erosion of purchasing power that has occurred. (For example, depreciation expense for equipment is based on its actual cost, rather than on the current cost of replacing it.) On this historic cost basis, 1982 income taxes paid by the supermarket industry were 35 percent of pre-tax profits. However, when the income statement is adjusted (downward) for inflation, the 1982 income taxes represent 109 percent of pre-tax profits, a significant decrease from previous years and a direct result of the decreased rate of inflation.



FINANCIAL STATEMENTS

3

Year Summary

Income Statement

The account balances in the income statement presented below have been expressed as percentages of sales, on an historic cost basis.

Income Statement for the Supermarket Industry
(In Percentages; Sales = 100%)

	1980	1981	1982
Sales	100.00%	100.00%	100.00%
Cost of Sales and Operating Expenses	98.20	98.62	98.24
Interest Expenses	.60	.51	.48
Total Costs & Expenses	98.80	99.13	98.72
Operating Income	1.20	.87	1.28
Other Income	.36	.55	.34
Income before Taxes	1.56	1.42	1.62
Total Taxes on Income	.55	.53	.57
Extraordinary Items (Net)	(.04)	—	.01
NET INCOME	.97%	.89%	1.06%

Balance Sheet

The account balances in the balance sheet presented below have been expressed as percentages of total assets, on an historic cost basis.

End-of-Year Balance Sheet for the Supermarket Industry
(In Percentages; Total Assets = 100%)

ASSETS	1980	1981	1982
CURRENT ASSETS			
Cash	6.86%	8.03%	7.10%
Accounts Receivable	3.65	4.12	3.80
Marketable Securities	3.13	2.72	3.26
Inventory (Note A)	35.26	35.10	33.29
Other Current Assets	3.31	2.53	4.38
Total Current Assets	52.21	52.50	51.83
PROPERTY & EQUIPMENT (Note B)			
Land	2.32	2.30	2.32
Buildings	21.86	14.43	18.78
Fixtures & Equipment	39.73	40.94	40.83
Leasehold Improvements	7.29	9.62	7.30
Total Property & Equipment	71.20	67.29	69.23
Reserves for Depreciation	(28.51)	(26.01)	(29.33)
Net Property & Equipment	42.69	41.28	39.90
OTHER ASSETS	5.10	6.22	8.27
TOTAL ASSETS	100.00%	100.00%	100.00%

NOTE A: Some firms value at least part of their inventory on a LIFO (last-in, first-out) basis. End-of-year inventories would have been increased if valued on a FIFO (first-in, first-out) basis.

NOTE B: Property under capitalized leases is included in the appropriate property categories based on the type of property leased.

End-of-Year Balance Sheet for the Supermarket Industry
(In Percentages; Total Liabilities = 100%)

LIABILITIES & NET WORTH	1980	1981	1982
CURRENT LIABILITIES			
Notes Payable	2.39%	2.23%	3.16%
Accounts Payable	21.62	22.14	20.82
Income Taxes Payable	1.57	1.60	1.26
Other Current Liabilities	12.41	13.70	13.31
Total Current Liabilities	37.99	39.67	38.55
LONG-TERM DEBT			
Mortgages	6.50	3.81	5.38
Bank Loans	4.84	6.46	4.61
Bonds & Debentures	1.00	1.56	3.81
Capitalized Lease Obligations	9.37	6.83	7.50
Other Noncurrent Liabilities	2.75	3.14	3.00
Total Long-Term Debt	24.46	21.80	24.30
DEFERRED LIABILITIES	2.97	1.56	2.01
Total Liabilities	65.42	63.03	64.86
NET WORTH			
Common Stock Outstanding or Proprietorship	4.54	8.35	4.95
Preferred Stock Outstanding	.80	1.05	.96
Paid-in Surplus	5.74	6.32	5.81
Retained Earnings	24.17	22.72	24.79
Treasury Stock	(.67)	(1.47)	(1.37)
Total Net Worth	34.58	36.97	35.14
TOTAL LIABILITIES & NET WORTH	100.00%	100.00%	100.00%

Historical vs. Inflation-Adjusted Balance Sheet Categories

Certain balance sheet captions were grouped in categories, which have been expressed as percentages of total assets, in both historical dollars and inflation-adjusted dollars. The most significant impact of the inflation adjustments was to restate (i.e. increase) the value of "net property and equipment" in current year dollars. (This increase was also added to "net worth".) These adjustments recognize that the current costs of reproducing existing supermarket properties are significantly higher than the depreciated historic cost. Investors in supermarket properties are unable to realize those gains unless the company is dissolved or sold.

Balance Sheet Categories as Percent of Total — Historic Cost Basis

	1980	1981	1982
Assets			
Inventory	35%	35%	33%
Other Current Assets	17	18	19
Net Property & Equipment	43	41	40
Other Assets	5	6	8
Total	100%	100%	100%
Liabilities and Total Net Worth			
Current Liabilities	38%	40%	39%
Long Term Liabilities	27	23	26
Net Worth	35	37	35
Total	100%	100%	100%

Balance Sheet Categories as Percent of Total — Adjusted for Inflation

	1980	1981	1982
Assets			
Inventory	28%	28%	26%
Other Current Assets	12	11	12
Net Property & Equipment	56	57	57
Other Assets	4	4	5
Total	100%	100%	100%
Liabilities and Net Worth			
Current Liabilities	30%	32%	29%
Long Term Liabilities	22	18	22
Net Worth	48	50	49
Total	100%	100%	100%

METHODOLOGY

Approach

The Review was developed from two primary sources of data: a survey mailed to the members of FMI and annual reports filed with the SEC on Form 10-K.

In 1982, most of the financial data were supplied by the companies that responded to the survey. Data were not used for any company with total sales of less than $2 million. Financial data for several large publicly traded companies were obtained from annual reports filed with the SEC. In all, data were collected from 131 companies that operated 11,428 stores.

In previous reviews, financial data were grouped into two strata — companies with sales of less than $10 million and those with sales of $10 million and over. Industry growth, both real and inflationary, has caused the operating results of mid-size companies to become "buried" in the larger companies group. Therefore, in 1982, the data were further stratified to distinguish those companies with sales of more than $10 million but less than $50 million.

In order to develop the industry averages reported, means were calculated for each strata and were weighted, using the relationships shown in the table below. The stratification and weighting of data help eliminate year-to-year changes that result from changes in the sample of firms submitting surveys.

We believe this method of estimating financial data for the supermarket industry provides the best published measurement of trends in the industry's capital structure. It does not, however, totally eliminate the problem of segregating supermarket operations from other lines of business in a diversified company.

Supermarket Population Based on 1977 Census of Retail Trade*

Firm Sales (Millions)	% of Total Firms	1977 Sales (Millions)	% of Total Sales
Less than $10	92.9%	$ 27,832	22.2%
Between $10 and $50	5.3%	12,800	10.2%
$50 and over	1.8%	84,823	67.6%
	100.0%	$125,445	100.0%

*Source: U.S. Census Bureau (latest available data)

Inflation Adjustments

The Financial Accounting Standards Board (the "FASB") has recognized that financial statements prepared on the basis of historical costs may not be meaningful in times of rapid inflation. As a result, Statement of Financial Accounting Standards No. 33 requires large companies to present data which reflect the impact of inflation. One method prescribed in SFAS No. 33 is to adjust cost of sales and depreciation from the amounts recorded in historical dollars to current year dollars. This approach, called constant dollar accounting, removes the effect of inventory profits on cost of sales from the income statement, and increases the depreciation charge to amounts reflective of the current costs of replacing assets. The Consumer Price Index for All Urban Consumers is used to make such adjustments.

After adjusting for the effects of inflation on cost of sales and depreciation, the industry has shown significant losses over the last several years. Reflecting the decreased rate of inflation the industry essentially broke even in 1982. This indicates that current earnings may be unable to provide enough capital for inventory or property replenishment.

Net Income for the Supermarket Industry Adjusted for Inflation
(Expressed as a Percent of Sales)

	1980	1981	1982
Net income, as reported	.97 %	.89 %	1.06 %
Adjustments to reflect the impact of inflation on:			
Cost of sales	(.82)	(.62)	(.28)
Depreciation	(.60)	(.68)	(.83)
Net income adjusted for inflation	(.45)%	(.37)%	(.05)%

It is important, however, to consider one additional element during periods of inflation—gain or loss in purchasing power. In times of inflation, businesses that hold cash are at a disadvantage in terms of general purchasing power because their cash will buy less at the end of the period than at the beginning. On the other hand, entities that have debts during inflationary periods may gain an advantage because their debts will be repaid with dollars of lower purchasing power. Statement of Financial Accounting Standards No. 33 requires that the net of these gains and losses be disclosed separately from income from continuing operations. This separate disclosure requirement reflects the FASB's concern that a company can gain from borrowing. (The FASB believed that a gain in purchasing power associated with debt is a sign of successful management only when the funds have been invested in assets that maintain their purchasing power.) As a result, the gains in purchasing power that the supermarket industry has realized on monetary items have not been reflected in the inflation-adjusted data that have been previously presented in this report. These data, however, have been included in the following table.

Net Income for the Supermarket Industry Adjusted for Inflation
(Expressed as a Percent of Sales)

	1980	1981	1982
Net income, as reported	.97 %	.89 %	1.06 %
Adjustments to reflect the impact of inflation on:			
Cost of sales	(82)	(.62)	(.28)
Depreciation	(.60)	(.68)	(.83)
Purchasing power	.96	.69	.50
Net income adjusted for inflation and purchasing power	.51 %	.28 %	.45 %

Definitions

Balance Sheet Captions

INVENTORY includes all goods held for sale by supermarket companies.

OTHER CURRENT ASSETS include all assets (except inventory) with a defined life of less than one year. (e.g., cash, accounts receivable, prepaid expenses, short-term investments, etc.)

NET PROPERTY & EQUIPMENT is all property, plant and equipment, including capital leases, less accumulated depreciation and amortization.

OTHER ASSETS include all assets (except property and equipment) with a defined life greater than one year. (e.g., investments in other companies, long-term receivables, ets.)

CURRENT LIABILITIES include all debts and expenses which are due within one year. (e.g., accounts payable, accrued liabilities, current portions of long-term debt, etc.)

LONG-TERM LIABILITIES include all debts and expenses which are due after one year. (e.g., long-term debt, capital lease obligations, deferred taxes, etc.)

NET WORTH is merely the difference between total assets and total liabilities. It is typically comprised of stock, paid-in-surplus, retained earnings and treasury stock.

Income Statement Captions

SALES represent all sales reported by supermarket companies

COST OF SALES AND OPERATING EXPENSES include the cost of merchandise sold by supermarkets plus all the other expenses of operating the stores, distribution facilities, and the central office.

INTEREST EXPENSE includes all interest charged on short- or long-term debt and on capital lease obligations.

OTHER INCOME includes all non-operating income (e.g., interest income, gain on sale of securities, etc.)

TOTAL TAXES ON INCOME are the Federal and state taxes imposed on the supermarket companies which are based on net income as reported to the government.

EXTRAORDINARY ITEMS include all items which occur infrequently and are unusual in nature (e.g., provisions for the disposition of facilities, realization of tax loss carry forwards, etc.)

Ratios

PROFIT MARGIN is the ratio of net income to sales.

RETURN ON TOTAL ASSETS is the ratio of net income to total assets.

RETURN ON NET WORTH is the ratio of net income to net worth.

Inflation Adjustments

INFLATION ADJUSTED NET INCOME is equal to net income as reported in historical dollars, less "constant dollar" adjustments to reflect the impact of inflation on (1) cost of sales, (i.e., to remove the effect of inventory profits from cost of sales) and (2) depreciation (i.e., to increase the depreciation charge to reflect the current cost of replacing assets.)

CONSTANT DOLLAR ACCOUNTING is a method of reporting financial elements in dollars which have the same general purchasing power.

MONETARY ITEMS are assets or liabilities which will be realized or paid for in cash for the exact amount of the amounts recorded on the balance sheet.

NON-MONETARY ITEMS are assets or liabilities which cannot be converted directly to cash for the amount recorded on the balance sheet. (e.g., inventory, property and equipment, deferred credits, etc.)

PURCHASING POWER GAIN OR LOSS is found by restating in constant dollars the (1) opening and closing balances of monetary assets and liabilities, and (2) transactions in monetary assets and liabilities.

Food Marketing Institute, a non-profit trade association, conducts programs in research, education and public affairs on behalf of its members—retailers and wholesalers from corner stores to supermarket chains—and their customers. FMI membership includes food chains, independent grocers, voluntary wholesalers and cooperatives in the United States, Canada and about 30 foreign countries.